Supreme Court, U.S.
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No. 93-1524

IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

W. KENNETH TREGENZA, JAMES E. HAAS, and ERWIN B. SEEGERS, on behalf of themselves and a class of persons similiarly situated,

Petitioners,

v.

GREAT AMERICAN COMMUNICATIONS COMPANY, a Florida corporation, and SHEARSON LEHMAN BROTHERS, INC., a Delaware corporation,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Seventh Circuit

RESPONDENTS' BRIEF IN OPPOSITION

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QUESTION PRESENTED

Whether the Seventh Circuit correctly found that courts may apply the doctrine of inquiry notice to the one year limitations period contained in Section 9(e) of the Securities Exchange Act of 1934?

LIST OF PARTIES

Petitioners-Plaintiffs:

Kenneth Tregenza

James E. Haas

Erwin B. Seegers

Respondents-Defendants:

Great American Communications Company

Lehman Brothers Inc. (Lehman Brothers Inc. is the successor corporation to the corporation that was formerly known as Shearson Lehman Brothers Inc.).

The following is furnished in compliance with Supreme Court Rule 29.1:

Lehman Brothers Inc.

Parent Company—The American Express Company
Subsidiaries (except wholly owned)—None

Great American Communications Company

Parent Company—None
Subsidiaries (except wholly owned)—None

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RESPONDENTS' BRIEF IN OPPOSITION

OPINIONS BELOW

The opinion of the Seventh Circuit is reported at 12 F.3d 717 (7th Cir. 1993) and is reproduced in Petitioners' Appendix ("App.") at pages 1-10. The Judgment of the Seventh Circuit is reproduced at App. 11. The opinion of the District Court is reported at [1993 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 97,745 (N.D. Ill., Apr. 30, 1993) and is reproduced at App. 12-31.

STATUTES INVOLVED

The statutory provisions involved are §§ 9(e) and 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78i(e) and 78j(b). Pursuant to Supreme Court Rule 24(f), these statutes are set forth in the Appendix hereto.

STATEMENT OF THE CASE

This action was filed by Petitioner W. Kenneth Tregenza ("Tregenza") on September 21, 1992 as a purported class action on behalf of persons who purchased common stock of Great American Communications Company ("GACC") during the time period from October 11, 1989 to December 17, 1991. On November 3, 1992, an Amended Complaint was filed which also added Petitioners James E. Haas ("Haas") and Erwin B. Seegers ("Seegers"). Both GACC and Shearson Lehman Brothers Inc. ("Lehman") were named as defendants. The Amended Complaint alleged claims under § 10(b) of the Securities Exchange Act of 1934 (the "1934 Act") and Securities and Exchange Commission Rule 10b-5, 17 C.F.R. § 240.10b-5 (1990), promulgated thereunder, § 12(2) of Securities Act of 1933 (the "1933 Act"), the Illinois Securities Law of 1953, Ill. Rev. Stat., ch. 121-1/2, §§ 137.1 *et seq.*, and common law negligent misrepresentation.

The gravamen of the Amended Complaint is that Respondents conspired to sell GACC common stock to the public through a series of misrepresentations designed to artificially inflate the price of the stock. Petitioners claimed that on October 11, 1989, Lehman sold GACC common stock to Tregenza and others at a price of $12.50 per share based upon alleged misrepresentations by Lehman that the "stock was worth twice as much as the current selling price," would trade well into the $20's within two years, and that the downside risk at $12.50 a share was less than 10%, *i.e.*, the stock would not drop below $11.25 per share. Tregenza also claimed that the shares he purchased were among the 3.65 million "newly issued shares" of GACC sold on October 11, 1989, and alleged a separate claim under the Illinois Securities Act asserting that his shares purchased on that date were not properly registered.[1]

Petitioners also claimed that after October 11, 1989 and continuing up to and including December 17, 1991, Lehman sold GACC common stock to Petitioners Haas and Seegers, as well as to others, at prices as high as $10.875 per share, through alleged misrepresentations by Lehman that the stock price would rise and trade well into the $20's within

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[1] Specifically, the Amended Complaint alleged that GACC negotiated an agreement with Lehman whereby Lehman: (i) purchased various amounts of debt from private debtholders; and (ii) exchanged that debt with GACC for 3.65 million shares of "newly issued" GACC common stock on October 12, 1989. Lehman is alleged to have sold those "newly issued" shares to the public on October 11, 1989 in violation of the Illinois Securities Act. Tregenza alleged a separate claim under the Illinois Act in Count III of the Amended Complaint regarding his purchase on that date. This state law claim was dismissed, without prejudice, upon the dismissal of the federal claims. Both GACC and Lehman have denied any wrongful conduct with respect to this transaction which was publicly announced on October 12, 1989.

two years, GACC was worth far more than the stock price indicated, the stock only had a 10% downside risk and GACC's largest shareholder would not allow the stock price to decline any further. Haas alleged that between November 15, 1989 and November 2, 1991 he purchased a total of 117,500 shares of GACC in the open market at prices ranging from $10.75 to $1.22 per share. Seegers alleged that between November 10, 1989 and June 10, 1991 he purchased a total of 50,000 shares in the open market at prices ranging from $10.875 to $2 per share. All of these purchases by Haas and Seegers were made at continually declining prices. None of the Petitioners contends that anyone from GACC met with or spoke to them concerning their purchases of GACC stock.

The Seventh Circuit affirmed the District Court's finding that the undisputed facts demonstrated that Petitioners were fully aware by no later than October 1990 that the price of GACC stock had performed directly contrary to the representations upon which Petitioners allegedly relied in making their purchases. As the Seventh Circuit found, "[i]mmediately after the sale of the stock on October 12, 1989, its market price began [an] exorable [decline]. By October 1990, the price had fallen to $1.50. Later it fell below $1. It has never come back up." 12 F.3d at 720. The fall to $1.50 represented an 88% decline from Tregenza's purchase price and an 86% decline from Haas' and Seegers' initial purchase prices. Both the Seventh Circuit and the District Court found that this price decline by October 1990 was directly contrary to the representations allegedly made at the time of purchase that the stock's downside risk was no more than 10% and that the stock would trade well into the $20's within two years. As the Seventh Circuit concluded, "an investor would have become suspicious and investigated when Lehman's emphatic and precise prediction

was so swiftly and dramatically falsified." 12 F.3d at 720 (citations omitted).

Thus, the Seventh Circuit, in an opinion written by Chief Judge Posner, affirmed the District Court's finding that Petitioners were placed on inquiry notice of their claims by no later than October 1990—almost two years before this action was filed in September, 1992. *Id.* Furthermore, the Seventh Circuit found nothing to suggest that Congress intended to prevent courts from applying the traditional doctrine of inquiry notice to § 9(e)'s one-year limitations period. *Id.* at 721-22. The Seventh Circuit stated:

> The precise question, then, is not: Does section 9(e) incorporate the rule of inquiry notice? It is: are courts free to apply to the section the judge-made doctrine of inquiry notice, long applied in fraud cases outside as well as inside the securities field? [citations omitted]. Nothing in the language, history or purpose of section 9(e) forecloses so modest and traditional an exercise of judicial creativity. It is traditional in securities law as well as in other fields.

Id. at 722.

The Seventh Circuit found that the utility of inquiry notice was not diminished by § 9(e)'s three-year period of repose:

> The utility of inquiry notice and hence the propriety of our interpretation may seem diminished by the presence of a three-year statute of repose. Not so—for section 13 of the 1933 Act has the same three-year statute of repose yet Congress wrote inquiry notice into the one-year statute of limitations in that section.

Id.

Moreover, the court observed that its interpretation of the statute was fully supported by policy considerations:

> Three years is an age in the stock market. If the suspicious investor had a wide choice of times at which to sue within a three-year period rather than being required to sue no more than one year after the earliest possible date, the opportunistic use of the federal securities laws to protect investors against market risk would be magnified. These plaintiffs waited patiently to sue. If the stock rebounded from the cellar they would have investment profits, and if it stayed in the cellar they would have legal damages. Heads I win, tails you lose. This tactic is discouraged by the doctrine of inquiry notice, which we hold is applicable in Rule 10b-5 suits.

Id.

REASONS WHY THE PETITION SHOULD BE DENIED

I.

SUMMARY OF THE ARGUMENT

The decision of the Seventh Circuit in this case is fully consistent with decisions of this Court and other Courts of Appeal. In fact, there is no genuine conflict between the decision of the Seventh Circuit in this case and the decisions of any other Circuit Court.

Indeed, this Court has twice denied review of the same issue presented by Petitioners here. *Dodds v. Cigna Securities, Inc.*, 12 F.3d 346 (2d Cir. 1993), *cert. denied*, 62 U.S.L.W. 3657 (U.S., Apr. 4, 1994); *Anixter v. Home-Stake Production Co.*, 977 F.2d 1549 (10th Cir. 1992), *cert. denied sub nom. Thorner v. Cross*, 113 S. Ct. 1842 (1993) (denying

a Cross-Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit seeking review of the same issue).[2] The same result should follow here.

II.

THE SEVENTH CIRCUIT'S DECISION DOES NOT CONFLICT WITH THIS COURT'S DECISION IN *LAMPF*

In *Lampf*, this Court did not decide the issue that was resolved in *Tregenza*, *i.e.*, whether courts may apply the judicial doctrine of inquiry notice to the one year limitations period contained in § 9(e). Therefore, there is no conflict between *Tregenza* and this Court's decision in *Lampf*.

This Court ruled in *Lampf* that private causes of action under § 10(b) and Rule 10b-5 are governed by § 9(e) which provides a limitations period of one year "after discovery of the facts constituting the violation", but not more than three years after the violation. 111 S. Ct. at 2782. The Court's majority opinion in *Lampf* chose § 9(e) as the governing statute, but never addressed whether discovery under the one-year period contained in that statute runs from the

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[2] The issues presented by the Petition for a Writ of Certiorari in *Dodds* are reported at 62 U.S.L.W. 3649 (U.S. Mar. 29, 1994). The issues presented by the Cross-Petition for a Writ of Certiorari in *Thorner* are reported at 61 U.S.L.W. 3690 (U.S. Apr. 6, 1993). The Petitioners in *Dodds* and the Cross-Petitioners in *Thorner* made the same arguments based on *Lampf, Pleva, Lipkind, Prubis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 115 L. Ed. 2d 321 (1991), *In re Data Access Systems Securities Litigation*, 843 F.2d 1537 (3d Cir.), *cert. denied sub nom. Vitiello v. Kahlowsky & Co.*, 488 U.S. 849, 109 S. Ct. 131, 102 L. Ed. 2d 103 (1988), and *Gruber v. Price Waterhouse*, 911 F.2d 960 (3d Cir. 1990), as Petitioners do here. *See Dodds* Petition for a Writ of Certiorari (No. 93-1419, filed Mar. 10, 1994); *Thorner* Cross-Petition for a Writ of Certiorari (No. 92-1294, filed Jan. 25, 1993).

date of inquiry notice as opposed to from the date of actual knowledge.

However, Justice Kennedy filed a dissenting opinion in *Lampf*, agreeing with the majority opinion that "a limitations period [of] 1-year-from-discovery rule" was appropriate, 111 S. Ct. 2788, which he described as running from the time "an investor discovered *or should have discovered* a violation." *Id.* at 2790 (emphasis supplied). The Court expressly commented on this dissenting opinion and did not disagree with Justice Kennedy's conclusion that the one-year period runs from inquiry, as well as actual, notice: "Justice KENNEDY would borrow the one-year limitations period contained in the 1934 Act but not the accompanying period of repose." *Id.* at 2782 n. 8.

Similarly, the Tenth Circuit concluded that *Lampf* did not decide that the one year limitations period of § 9(e) runs only from actual knowledge of a violation:

> When the Court selected §9(e), it did not necessarily indicate a preference for the type of notice of the violation but sought a "governing" standard to link the implied §10(b) remedy to those express securities causes of action which uniformly require one year after notice of the violation and not more than three years after the violation.

Anixter v. Home-Stake Production Co., 947 F.2d 897, 899 (10th Cir. 1991), *vacated on other grounds sub nom. Dennler v. Trippet*, 112 S. Ct. 1658, 118 L. Ed. 2d 382 (1992) (footnote omitted).

Accordingly, since the issue resolved in *Tregenza* was not addressed in *Lampf*, there is no conflict between the two opinions.

III.

NO GENUINE CONFLICT EXISTS AMONG THE CIRCUIT COURTS OF APPEAL

Petitioners also argue that *Tregenza* conflicts with decisions of the Third Circuit. That is not correct. The Third Circuit has not held that courts may not apply the judicial doctrine of inquiry notice to the one year limitations period contained in § 9(e).

As Petitioners concede, the Second and Tenth Circuits agree with the Seventh Circuit that inquiry notice triggers the running of the one year limitations period of § 9(e). *See Dodds*, 12 F.3d at 353 (2d Cir. 1993); *Menowitz v. Brown*, 991 F.2d 36, 41 (2d Cir. 1993); *Anixter*, 947 F.2d 897 (10th Cir. 1991).

The Fourth Circuit concurs. In *Howard v. Haddad*, 962 F.2d 328 (4th Cir. 1992), the Fourth Circuit stated that the applicable inquiry under *Lampf* is whether the plaintiff commenced his § 10(b) action "within one year after the discovery of the facts constituting the violation" which meant that the "one year discovery limitations period thus began running either when [plaintiff] had notice of these facts or when, exercising reasonable diligence, he would have discovered them." *Id.* at 330 (citation omitted).

The Fifth Circuit, as noted in *Tregenza*, has placed the same inquiry notice interpretation on Section 29(b) of the 1934 Act, which, similar to § 9(e), requires that an action be brought "within one year after the discovery that such sale or purchase involves such violation." 15 U.S.C. § 78cc(b); *Goldenberg v. Bache & Co.*, 270 F.2d 675, 681 (5th Cir. 1959) ("discovery" pursuant to § 29(b) "means either actual knowledge or notice of facts which, in the exercise of due diligence, would have led to actual knowledge of the violation." (footnote omitted)).

The decisions of the Third Circuit cited by Petitioners are not to the contrary. *In re Data Access*, 843 F.2d 1537 (3d Cir.), *cert. denied sub nom. Vitiello v. Kahlowsky & Co.*, 488 U.S. 849, 109 S. Ct. 131, 102 L. Ed. 2d 103 (1988), *Gruber*, 911 F.2d 960 (3d Cir. 1990), and *Westinghouse Elec. Corp. By Levit v. Franklin*, 993 F.2d 349 (3d Cir. 1993), either do not address the issue of what notice is required to commence the one year limitations period of § 9(e), or discuss the issue solely in dicta.

Data Access, decided before *Lampf*, does not discuss the issue of whether "discovery" under § 9(e) includes inquiry as well as actual notice. The court simply recited the language of the statute—that claims under § 10(b) and Rule 10b-5 are governed by a limitations period of "one year after the plaintiff discovers the facts constituting the violation, and in no event more than three years after such violation." 843 F.2d at 1550.

In *Gruber*, the Third Circuit expressly declined to reach the issue, noting only in a footnote in dicta that while a district court's adoption of an inquiry notice standard to a § 10(b) claim "may" have been error, it was "harmless error" and the issue was "irrelevant" to the disposition of the appeal. 911 F.2d at 964 n. 4.

In *Westinghouse*, the only questions presented on appeal were whether the one-year/three-year limitations periods for claims brought under § 10(b) also applied to claims brought under § 14(a) of the 1934 Act, 15 U.S.C. § 78n(a), and whether the court's prior holding in *Data Access* should be applied retroactively. 993 F.2d at 350. The court expressly declined to address the issue of whether only actual notice was required to commence the running of the limitations period governing the investors' claims. The court stated that it "will be for the district court, and not us, to

consider in the first instance the application of our holding to the relevant facts before it." *Id.* at 356.

Moreover, in *Westinghouse*, the Third Circuit cited with approval the Seventh Circuit's decision in *Short v. Belleville Shoe Mfg. Co.*, 908 F.2d 1385 (7th Cir. 1990), *cert. denied*, 111 S. Ct. 2887, 115 L. Ed. 2d 1052 (1991), and the Second Circuit's decision in *Ceres Partners v. GEL Assocs.*, 918 F.2d 349 (2d Cir. 1990), as "adopt[ing] the result and reasoning we announced in *Data Access*." 993 F.2d at 352 n. 1. In *Short*, the Seventh Circuit borrowed § 13's limitation periods, the one year prong of which by its own terms runs from inquiry notice. 908 F.2d at 1390-91. In *Ceres*, the Second Circuit borrowed the 1934 Act's one-year/three-year periods under §§ 9(e) and 18(a), which it also found to run from inquiry notice. 918 F.2d at 364. *See Menowitz*, 991 F.2d at 41 ("The 1934 Act limitations period adopted in *Ceres*, and later adopted in *Lampf*, requires that claims be brought within one year of discovery of the facts giving rise to the violation. We have previously stated that 'discovery' under the 1934 Act limitation provisions includes constructive or inquiry notice, as well as actual notice." (citations omitted)).

That the Third Circuit has not definitively addressed this issue is confirmed by the post-*Gruber* and post-*Westinghouse* decisions of district courts within the Third Circuit that continue to apply an inquiry notice standard to § 10(b) claims. Indeed, after *Gruber*, the Third Circuit affirmed without opinion a district court decision expressly holding that inquiry notice is the proper standard under § 9(e). *See Manning v. Maloney*, 787 F. Supp. 433, 436 (M.D. Pa.), *aff'd*, 980 F.2d 722 (3d Cir. 1992). *See also Rolo v. City Investing Co. Liquidating Trust*, 1994 WL 14474, at *56 (D.N.J. Jan. 19, 1994) (Under the one-year limitation provision set forth in *Data Access* the "discovery need not be

actual; 'discovery' under the 1934 Act limitation provisions includes constructive or inquiry notice." (citations omitted)); *Kress v. Hall-Houston Oil Co.*, RICO Bus. Disp. Guide (CCH) ¶ 8348, at 14598, 1993 WL 166274 (D.N.J. May 12, 1993) ("[T]he *Lampf* rule does not require actual knowledge of the alleged wrong to trigger the running of the statute of limitations. Rather, 'the time to file suit begins to run when the investor either knows or in the exercise of reasonable diligence could have discovered the facts on which the suit is based.' *Norris v. Wirtz*, 818 F.2d 1329, 1334 (7th Cir.), *cert. denied*, 484 U.S. 943, 108 S. Ct. 329 (1987).").

Thus, no conflict has been created by the Third Circuit because the Third Circuit has never expressly held that discovery under the one-year prong of § 9(e) only runs from actual notice. Moreover, the Seventh Circuit's decision in this case is fully consistent with decisions of the Second, Fourth, Fifth and Tenth Circuits, and there is no conflict between those Circuits and any other Circuit on this issue.

CONCLUSION

For all the foregoing reasons, Respondents respectfully request that the Petition for Writ of Certiorari be denied.

Respectfully submitted,

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